
Audit of the National Student Loan Program's Establishment of the Federal Family Education Loan Program Federal and Operating Funds

FINAL AUDIT REPORT



**ED-OIG/A07-B0002
September 2002**

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U.S. Department of Education
Office of Inspector General
Region VII - Kansas City Office

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UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF INSPECTOR GENERAL

SEP 27 2002

ED-OIG/A07-B0002

Ms. Nancy Weiderspan, President
National Student Loan Program
1300 O Street
Lincoln, NE 68508

Dear Ms. Weiderspan:

Attached is our report entitled Audit of the National Student Loan Program's Establishment of Federal Family Education Loan Program Federal and Operating Funds. The report incorporates the comments you provided in response to the draft audit report. If you have any additional comments or information that you believe may have a bearing on the resolution of this audit, you should send them directly to the following Education Department official, who will consider them before taking final Departmental action on the audit:

Theresa S. Shaw, Chief Operating Officer
Federal Student Aid
U.S. Department of Education
Union Center Plaza, Room 112G1
830 First Street, NE
Washington, DC 20202

Office of Management and Budget Circular A-50 directs Federal agencies to expedite the resolution of audits by initiating timely action on the findings and recommendations contained therein. Therefore, receipt of your comments within 30 days would be greatly appreciated.

In accordance with the Freedom of Information Act (5 U.S.C. §552), reports issued to the Department's grantees and contractors are made available, if requested, to members of the press and general public to the extent information contained therein is not subject to exemptions in the Act.

Sincerely,

Thomas A. Carter
Assistant Inspector General for Audit

Attachment

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Audit of the National Student Loan Program's Establishment of Federal Family Education Loan Program Federal and Operating Funds

Executive Summary

We conducted an audit of the National Student Loan Program's (NSLP's) establishment of Federal Family Education Loan (FFEL) Program Federal and Operating Funds, whose establishment was required by the 1998 amendments to the Higher Education Act of 1965 (HEA).

We found that NSLP understated the beginning balance of its Federal Fund by \$942,941, because it used federal funds to pay for unallowable and unsupported costs for marketing and public relations, information systems, employee benefits, administration, and communication and design during Fiscal Year (FY) 1998. We also found that NSLP used federal funds to pay for \$1.73 million of unsupported FY 1998 salary costs and did not maintain and update adequate standards of conduct.

We recommend that the Chief Operating Officer (COO) for Federal Student Aid¹ (FSA) require NSLP to reimburse the Federal Fund

- \$231,525 for unallowable marketing and public relations costs;
- \$440,626 for unallowable information system costs;
- \$4,015 for unallowable employee benefit costs;
- \$47,700 for unallowable administration costs; and
- \$4,317 for unallowable communication and design costs.

¹ Prior to March 6, 2002, Federal Student Aid was known as Student Financial Assistance but will be referred to as Federal Student Aid throughout this document.

We also recommend that the COO for FSA

- Require NSLP to provide supporting documentation for, or reimburse \$214,193 in unsupported FY 1998 marketing and public relations costs charged by the Foundation for Educational Services (FES) plus imputed interest calculated through September 30, 2001 to the Federal Fund.
- Require NSLP to provide supporting documentation for, or reimburse \$1.73 million FY 1998 salary expense it was charged plus imputed interest calculated through September 30, 2001 to the Federal Fund.
- Require NSLP to provide supporting documentation for, or reimburse \$565 in college fair advertisement costs charged by FES plus imputed interest calculated through September 30, 2001 to the Federal Fund.
- Require NSLP to maintain documentation sufficient to support salary costs charged by FES; and
- Assure that NSLP's conflict-of-interest standards adhere with federal regulations.

In most instances, NSLP disagreed with our findings. We have summarized its responses at the end of the respective findings and provided the full text of the responses as an appendix to this report.

Audit Results

We found that NSLP complied with the HEA and federal regulations governing the establishment of the Federal and Operating Funds, except that it understated the beginning balance of its Federal Fund by at least \$942,941 because it used federal funds to pay for unallowable and unsupported FY 1998 costs for marketing and public relations costs (\$445,718), information systems (\$440,626), employee benefits (\$4,015), administration (\$47,700), and communication and design (\$4,882). These expenditures were not in accordance with 34 C.F.R. § 682.410 (a)(2)(ii),² which provides that a guaranty agency must use the assets of its reserve fund to pay only costs that are reasonable and that are ordinary and necessary for the agency to fulfill its responsibilities under HEA. We also found that NSLP used federal funds to pay for unsupported FY 1998 salary costs (approximately \$1.73 million) and did not maintain and update adequate standards of conduct.

Finding No. 1 – Unallowable and Unsupported Marketing and Public Relations Costs

NSLP used federal funds for unallowable and unsupported marketing and public relations costs. As a result, the Federal Fund's beginning balance was understated. FES charged NSLP \$414,193 for FY 1998 "default prevention services" performed by Educational Planning Centers (EPCs). According to NSLP officials the EPCs spent 25 percent of their time on default prevention programs; therefore, NSLP was allocated 25 percent of the EPCs' costs. Statements in EPC annual reports indicated that the purpose of the EPCs was to market the names and images of FES and its affiliated companies. We concluded from these statements that EPCs were actually marketing/public relations departments for FES and its affiliates.

Prohibited uses of reserve fund assets in regard to public relations are defined under 34 C.F.R. § 682.418 (b)(8). These regulations state that the following are not allowable:

² All regulatory citations in this report are from the 1998 Volume of the Code of Federal Regulations unless otherwise noted.

Public relations, and all associated costs, paid directly or through a third party, to the extent that those costs are used to promote or maintain a favorable image of the guaranty agency. The term “public relations” does not include any activity that is ordinary and necessary for the fulfillment of the agency’s FFEL guaranty responsibilities under the HEA, including appropriate and reasonable advertising designed specifically to communicate with the public and program participants for the purpose of facilitating the agency’s ability to fulfill its FFEL guaranty responsibilities

. . . .

According to 34 C.F.R. § 682.410 (a)(11), “[T]he burden of proof is upon the guaranty agency, as a fiduciary under its agreements with the Secretary, to establish that costs are reasonable.”

Actual EPC costs for FY 1998 totaled \$856,770. According to FES’ cost allocation plan, NSLP should have been allocated \$214,193 (\$856,770 x 25 percent) for EPC services. NSLP paid a total of \$414,193 for the EPCs in FY 1998 (\$214,193 in monthly billings and \$200,000 for additional services in September 1998). NSLP officials could not provide supporting documentation showing that EPC costs were “designed specifically for . . . the purpose of facilitating [its] ability to fulfill its FFEL guaranty responsibilities.

NSLP officials could not provide supporting documentation showing NSLP had received additional “default prevention” services as of September 1998. Further review showed that FES posted this \$200,000 payment in a deferred revenue account, which means that it constituted a prepayment from the Federal Fund. As such, it was not allowable since the Federal Fund must only be used to pay lender claims and to pay the Operating Fund a default aversion fee. (Section 422A (d) of the HEA)

The payment of the \$214,193 in EPC costs is unsupported and the additional \$200,000 for FY 1998 EPC costs is unallowable.

Recommendations

We recommend that the COO for FSA require NSLP to

- 1.1 Reimburse the Federal Fund \$231,525. This amount includes

- (a) \$200,000 in unallowable EPC costs NSLP paid in FY 1998; and
 - (b) Imputed interest of \$31,525 calculated through September 30, 2001.³
- 1.2 Provide supporting documentation for, or reimburse \$214,193 in unsupported FY 1998 EPC costs charged by FES plus imputed interest calculated through September 30, 2001, to the Federal Fund.

NSLP Comments – NSLP did not agree with this finding. NSLP stated that the finding was incorrectly based on the Cost Principles of OMB Circular A-87 instead of the applicable authority for guaranty agency allowable costs (34 C.F.R. § 682.418 (b)(8)), which “allows ‘ordinary and necessary’ public relations activities.” NSLP stated that the EPC costs it was charged under the FES cost allocation plan were allocated on the basis of the number of presentations that were made to colleges and high schools, college fairs, and brochures distributed to prospective loan applicants. NSLP also claims that the 25 percent allocation from the EPCs was understated and that FES could have allocated at least 53 percent of the EPC costs to NSLP. NSLP stated that the \$200,000 charge it made in addition to the standard 25 percent rate was required for an end-of-year reconciliation.

OIG Response – NSLP’s comments did not alter our overall position on the finding. However, we modified the finding to address some of NSLP’s concerns. OMB Circular A-87, as well as 34 C.F.R. § 682.418 (b), applied to the EPC expenditures during FY 1998. We added the additional criteria to our report. We deleted a recommendation relating to recoveries from years subsequent to FY 1998. As discussed in the Other Matters section of this report, we determined subsequent to the issuance of the draft report that the OMB Circular A-87 criteria were not applicable to NSLP during those years.

NSLP did not provide adequate documentary evidence to support that the activities in which EPCs were engaged were “ordinary and necessary for the fulfillment of [NSLP’s] FFEL guaranty responsibilities under the HEA,” as required by 34 C.F.R. § 682.418 (b)(8). NSLP also did not provide documentation to support that its EPC allocation percentage from FES could have been much greater.

³ Throughout this report, imputed interest has been calculated by using the U.S. Department of the Treasury’s Current Value of Funds Rate.

The FY 1998 FES annual EPC reports included the following statements:

These contacts continuously provide us the opportunity to directly reach our target audience and the ability to market our companies products and services.

These new contacts provide additional opportunities to build a positive image and name recognition for FEF and NSLP.

NSLP did not provide any evidence that the additional \$200,000 in EPC costs paid in September 1998 were used for FFEL purposes. Our review showed that the September 1998 billing from FES included a year-end adjustment of \$3,671.52 for FY 1998 default prevention services. We found nothing to indicate there was any other year-end adjustment. NSLP did not explain why the \$200,000 appeared in a FES deferred revenue account. We found that NSLP was no longer being billed for a line item titled default prevention services after September 30, 1998.

Finding No. 2 – Unallowable Information System Costs

NSLP used federal funds to pay for \$380,629 of information system costs that its affiliate, FES, could not collect from other customers, specifically, the Utah Higher Education Assistance Authority (UHEAA) and the Utah State Board of Regents (USBR). As a result, the Federal Fund's beginning balance was understated. According to 34 C.F.R. § 682.410 (a)(2)(ii), a guaranty agency must use the assets of the reserve fund to pay only costs that are reasonable and that are ordinary and necessary for the agency to fulfill its responsibilities under the HEA.

In September 1998, NSLP paid \$380,629 to FES for information system charges that were unsupported by invoices. The only support NSLP provided for these charges, which covered 9,155 hours of service, was a spreadsheet showing these hours being allocated to UHEAA and USBR. These charges were for changes in computer programs that, according to NSLP officials, were needed to meet an industry standard for transmitting data called *Commonline*.⁴ The 9,155 hours were billed to NSLP for the following items:

⁴ *Commonline* is a computer program that makes it easier for schools, lenders, etc. to exchange information through common file layouts.

\$131,789	(2,512.66 hours x \$52.45/hour) for customer support related to <i>Commonline</i>
+ 444,038	(6,642.31 hours x \$66.85/hour) for programming support related to <i>Commonline</i>
- 195,198	Credit for <i>Commonline</i> costs covered by UHEAA/USBR
\$380,629	Total questioned information system costs billed to NSLP

NSLP and FES provided documentation to us that specified that UHEAA and USBR would pay FES no more than \$250,000 for charges relating to *Commonline*. FES billed NSLP for the charges above \$250,000. This was in addition to the *Commonline* charges on NSLP's monthly invoices from FES.

Recommendation

We recommend that the COO for FSA require NSLP to

2.1 Reimburse the Federal Fund \$440,626. This amount includes

- (a) \$380,629 in questioned information systems costs NSLP paid in FY 1998; and
- (b) Imputed interest of \$59,997 calculated through September 30, 2001.

NSLP Comments – NSLP disagreed with our finding. NSLP stated that the costs were reasonable, ordinary, and necessary. NSLP stated that FES collected all that it was due from UHEAA and USBR according to a fixed fee contract. Moreover, the Federal Fund benefited from the fully-collected contract and NSLP contends that it would have incurred all of the *Commonline* costs whether FES had the Utah contracts or not. NSLP states that the Federal Fund benefited from the \$195,198 billed to and paid by the Utah agencies.

OIG Response - NSLP's comments did not alter our position on the finding. NSLP did not provide evidence that these costs were reasonable, ordinary, and necessary. The only support that NSLP provided for the *Commonline* amounts was a spreadsheet that showed total FES Information Systems programming hours spent on various IS projects. Included with this spreadsheet were tapes and notes showing the *Commonline* support (2,512 hours) and programming (6,642 hours) allocated to the Utah organizations. A FES internal e-mail provided by FES stated “. . . bill NSLP for the time that we had allocated to SBR and UHEAA that they won't pay us for . . .” The FES contracts with UHEAA and USBR showed that these contracts were not fixed price contracts. The contracts did have fixed price elements but also allowed for

additional custom programming at a rate of \$90 per hour and customer support at a rate of \$75 per hour plus fees for daily consulting. The fixed price costs that UHEAA and USBR were obligated to pay amounted to \$735,000 per year plus additional customer programming, customer service, and consulting fees.

The UHEAA contract dated June 30, 1998, shows a \$25,000 monthly fee for the ULTRA software and a \$75,000 yearly fee for other software (noted as Exhibit A in the contract), which amounts to a total of \$375,000 fixed costs per year that UHEAA was obligated to pay. UHEAA was also responsible for any custom programming, customer support, or consulting beyond the services included in the monthly fees (noted as Section 7.b. in the contract).

The USBR contract dated June 30, 1998, shows a \$30,000 monthly fee for the EASEL and EDGE software (noted as Exhibit A in the contract), which amounts to a total of \$360,000 fixed costs per year that USBR was obligated to pay. USBR was also responsible for any custom programming, customer support, or consulting beyond the services included in the monthly fees (noted as Section 7.b. in the contract).

Paragraphs 7.a. of the UHEAA contracts states the following:

For the Licensed Programs and Documentation and related services described in Section 2 hereof, UHEAA shall pay the charges and costs set forth in Exhibits “A” and “C” respectively. . . . FES shall direct bill UHEAA for all license fees, services, and support, including charges for technical assistance provided by FES to each End User associated with UHEAA in accordance with Section 2(f) hereof

The USBR contract contained the same language regarding payment.

We deleted a recommendation relating to recoveries from years subsequent to FY 1998.

Finding No. 3 – Unallowable Benefit Costs

NSLP used federal funds to pay \$3,468 for unallowable benefit administration costs. We found that FES included the following costs in the Human Relations (HR) benefit administration cost pool that are unallowable per OMB Circular A-87, Attachment B, Section 18:

Employee Appreciation Day	\$ 1,121
Employee Relations – Basketball League	120
Employee Relations – Gifts	381
Holiday Party	5,197
Party Pak Expenses	1,066
Wellness Committee	244
	<hr/>
Total Unallowable Costs	<u>\$ 8,129</u>

We removed the unallowable costs of \$8,129 from the HR benefit administration cost pool, which resulted in a revised cost pool of \$441,339. We then calculated a revised HR benefit administration rate of \$.101, a difference of \$.002 from the \$.103 charged by FES. When we applied this difference to NSLP direct salaries of \$1,734,182.72, we calculated a \$3,468 NSLP overpayment to FES from the reserve fund.

Recommendation

We recommend that the COO for FSA require NSLP to

3.1 Reimburse the Federal Fund \$4,015. This amount includes

- (a) \$3,468 in unallowable benefit costs that NSLP paid to FES in 1998; and
- (b) Imputed interest of \$547 calculated through September 30, 2001.

NSLP Comments – NSLP did not agree with the first part of the finding as presented in the draft report regarding duplicative benefits cost. NSLP does not agree with the second part of this finding regarding unallowable human resource cost. It views Section 17 of Attachment B to OMB Circular A-87 as more relevant than Section 18, cited in our report. The NSLP response states that all of the questioned costs are allowable per Section 17 in that they support activities intended to improve employee morale, which is included as part of the title to Section 17, i.e., “Employee morale, health, and welfare costs.”

OIG Response – Based on NSLP’s response regarding duplicative benefits costs, we deleted that aspect of the finding. NSLP provided sufficient additional information to support its position. NSLP stated that because of the allocation plan complexities, officials offered to walk through the allocation process with the auditors and that we declined. We did have discussions with NSLP officials regarding the cost allocation plan during our fieldwork. We also deleted our

recommendation relating to recoveries from years subsequent to FY 1998. We did not change our position regarding the benefit administration costs. While entertainment (such as the party we cite in our report) may improve employee morale, it is nevertheless unallowable under OMB Circular A-87, Section 18.

Finding No. 4 – Unallowable Administration Costs

NSLP used federal funds to pay for unallowable administration costs amounting to \$41,205 (\$14,852 of directly billed insurance costs plus \$26,353 of indirect charges). These unallowable administration costs are summarized below.

Insurance

We analyzed the invoices and policy terms of insurance policies for director and officer liability, non-profit liability, and for a broker's blanket bond policy. FES directly billed NSLP for a portion of the costs for these policies and included a portion in the administration cost pool. We found that \$14,852 of the \$15,934 in insurance cost directly billed to NSLP and paid for with federal funds was unallowable. We also found that \$19,122 of the \$26,597 in insurance cost included in the FES administration cost pool was unallowable.

The above insurance costs were unallowable for two reasons. First, the amount of director and officer liability insurance allocated to NSLP was overstated because 12 of the 13 personnel listed in the insurance policy did not work for NSLP. According to 34 C.F.R. § 682.410 (a)(2)(ii)(A), guaranty agencies must use assets of the reserve fund only for costs that are allocable to the FFEL program. Second, all of the policies covered periods after the conclusion of FY 1998. We considered the costs of the policies prorated for the portion that extended beyond FY 1998 to be prepayments from the Federal Fund, because they were not allocable to the reserve fund in FY 1998. As such, they were not allowable since the Federal Fund must only be used to pay lender claims and to pay the Operating Fund a default aversion fee. (Section 422A (d) of the HEA)

Personnel Administration

The only expense in this category was severance pay of \$25,805 for a former FES employee. According to this individual's employment contract, FES was not obligated to provide severance pay because he resigned. Section 8 of the employment contract states:

Termination. Employer is obligated to pay the base salary due to Employee under the terms of this Agreement for the entire one year term of employment under this Agreement without limitation, reduction, or restriction, unless the Employee's employment is terminated as a result of the employee's attainment of normal retirement age, death, incapacity, resignation or is terminated for cause

In addition, OMB Circular A-87, Attachment B, 11 (g) states:

Payments in addition to regular salaries and wages made to workers whose employment is being terminated are allowable to the extent that, in each case, they are required by (a) law, (b) employer-employee agreement, or (c) established written policy.

Directors Fees and Expenses

Expenses in this category included the costs for a retreat for FES directors and wine for an FES board meeting. Our review of the documentation showed a \$12,489 invoice from Collegiate Financial Services, Inc. (an FES affiliate) to FES for an "April 1998 Board Meeting in Florida," of which \$11,480 was allocated to other cost centers as an indirect cost. The invoice shows food, beverage, golf, and tip expenses for various board members and their spouses. The retreat expense is not a reasonable cost to be paid for with federal funds and is, therefore, unallowable. We also noted that all of the other board meetings were held at FES offices in Lincoln, Nebraska. For one of the latter board meetings, documentation showed a \$101 charge for wine, which is also unallowable.

According to 34 C.F.R. § 682.410 (a)(2)(ii), a guaranty agency must use the assets of the reserve fund to pay only costs that are reasonable and that are ordinary and necessary for the agency to fulfill its responsibilities under the HEA.

According to 34 C.F.R. § 682.418 (b)(3), the following costs are not allowable: “amusement, diversion, hospitality suites, and social activities, and any costs associated with those activities, such as . . . meals, alcoholic beverages, lodging, rentals, transportation, and gratuities” OMB Circular A-87, Attachment B, Section 4 specifically disallows the cost of alcoholic beverages.

Recommendation

We recommend that the COO for FSA require NSLP to

4.1 Reimburse the Federal Fund \$47,700. This amount includes

- (a) \$41,205 in unallowable administration costs NSLP paid to FES in 1998, and
- (b) Imputed interest of \$6,495 calculated through September 30, 2001.

NSLP Comments – Insurance: NSLP agreed with our findings regarding the liability and blanket bond insurance policies but disagreed with some elements of our finding on the Director and Officer (D&O) insurance policy. NSLP comments that we overlooked Endorsement #8, dated June 1, 1997, which lists both NSLP and FES as corporations for which coverage was being provided, and that the 50 percent allocation to NSLP was accurate. NSLP agreed that a portion of the premiums covered a period beyond FY 1998 and that it should reimburse the Federal Fund the applicable portions of the NSLP and FES prepayments.

Personnel Administration: NSLP stated that the severance payment FES made to a former employee should be allowed since FES determined that such a payment would avoid the risks of litigation and related expenses.

Directors Fees and Expenses: NSLP concurred with this part of Finding No. 3.

OIG Response – Our review of NSLP’s comments did not change our position. We deleted our recommendation relating to recoveries from years subsequent to FY 1998.

Insurance: Our review of NSLP’s comments, as well as Endorsement #8, has not changed our position. The D&O policy states that “This policy shall pay the Loss of each and every Director, Officer, or Trustee of the Organization arising from any claim or claims first made against the Directors, Officers, or Trustees” The policy clearly covers losses on behalf of the directors,

officers, and trustees and as such, the cost should have been allocated by the number of directors, officers, or trustees at the two companies. Only one of the personnel listed as covered by this policy was an employee of NSLP and this is the only portion of the cost that should be directly allocated to NSLP.

Personnel Administration: We did not change our position on this matter. While the decision to make this payment may have best served FES' interests, this does not change the fact that using federal funds for the payment is unallowable.

Finding No. 5 – Unallowable and Unsupported Communication and Design Costs

NSLP used federal funds to pay for \$4,971 of unallowable and unsupported communication and design costs. These costs were unallowable under the following guidelines and cost principles of OMB Circular A-87:

- Section C.1.a of Attachment A of this circular states that costs are allowable only when they are “necessary and reasonable for proper and efficient performance and administration of Federal awards.”
- Section 2 of Attachment B of the circular states, “Advertising costs are allowable only when incurred for the recruitment of personnel, the procurement of goods and services, the disposal of surplus materials, and any other specific purposes necessary to meet the requirements of the Federal award.”
- Section 2 also states that public relations costs are allowable only when
 - (1) Specifically required by the Federal award . . . ;

- (2) Incurred to communicate with the public and press pertaining to specific activities or accomplishments that result from performance of the Federal award . . . ; or
 - (3) Necessary to conduct general liaison with news media and government public relations officers, to the extent that such activities are limited to communication and liaison necessary to keep the public informed on matters of public concern, such as notices of Federal contract/grant awards, financial matters, etc.
- Section 13 of Attachment B states, “Contributions and donations, including cash, property, and services, by governmental units to others, regardless of the recipient, are unallowable.”

We determined the following costs to be unallowable or unsupported under the aforementioned OMB cost principles:

- Advertising, e.g., for a college fair (\$565) and the “KEZG Festival of Music” (\$555);
- Marketing and Business Development (\$1,097);
- Printing and Copying, specifically printing for a “storytelling brochure” and for the Lincoln Public Schools Foundation (\$821);
- Employee Relations, e.g., sunglasses for employees, Paint-A-Thon T-shirts and supplies, and Jingle Bell Run Entry Fees (for the Arthritis Foundation) (\$713); and
- Dues and Subscriptions, specifically membership dues for the Lincoln Chamber of Commerce (\$543).

Recommendations

We recommend that the COO for FSA require NSLP to

5.1 Reimburse the Federal Fund \$4,317. This amount includes

- (a) \$3,729 in unallowable communication and design costs NSLP paid to FES in 1998, and

(b) Imputed interest of \$588 calculated through September 30, 2001.

- 5.2 Provide supporting documentation for, or reimburse \$565 in unsupported college fair advertisement costs charged by FES plus imputed interest calculated through September 30, 2001 to the Federal Fund.

NSLP Comments - NSLP concurred with this finding with two exceptions. In its view a college fair advertisement and membership dues for the Lincoln Chamber of Commerce are allowable. NSLP believes that the college fair function is a reasonable and allowable expense under the HEA. NSLP also stated that the Chamber of Commerce dues are allowable based on Attachment B, Section 30 of OMB Circular A-87, which states that cost of “memberships in business, technical, and professional organizations are allowable.”

OIG Response - Our review of NSLP’s comments did not change our overall position. We modified the recommendation to categorize the college fair advertisement unsupported because NSLP did not provide evidence that the fair was solely to disseminate FFEL information. As such, we could not determine whether this expense was reasonable or allowable. The provisions of Attachment B stand within the context of the basic cost principle guidelines of Section C.1.a. of Attachment A of the Circular, which reads as follows, “To be allowable under Federal awards, costs must . . . be necessary and reasonable for proper and efficient performance and administration of Federal awards.” Membership in a Chamber of Commerce is not necessary for a guaranty agency to fulfill its responsibilities under the HEA.

Finding No. 6 – Unsupported Salary Costs

FES charged NSLP approximately \$1.73 million in FY 1998 salary expenses that were not supported by required documentation. As a result, we were unable to determine if the charges were reasonable and appropriate.

OMB Circular A-87, Attachment B, 11, h (3), requires signed periodic certifications at least semi-annually for employees that work solely on a single federal cost objective in order for charges for their salaries and wages to be considered supported costs. The regulations at 34 C.F.R. § 682.410 (a)(2)(ii) provide that a guaranty agency must use the assets of the reserve fund to pay only costs that are reasonable and that are ordinary and necessary for the agency to fulfill its responsibilities under the HEA. According to 34 C.F.R. § 682.410 (a)(11)(iii), “the burden of

proof is upon the guaranty agency, as a fiduciary under its agreements with the Secretary, to establish that costs are reasonable.”

According to the FES Cost Allocation Plan, FES provides all staff (not including company officers) to perform the operating functions of member companies. FES only required timesheets for employees who worked on a part-time basis. All other employees were paid based on Employee Status Forms. These forms contained only basic information about the employees and their salary or hourly wage amounts. By not having timesheets or employee certifications available for review, we were unable to determine whether full-time salary and benefit costs paid by NSLP were allowable or allocable to NSLP.

Recommendations

We recommend that the COO for FSA require NSLP to

- 6.1 Provide required supporting documentation for, or reimburse \$1.73 million in FY 1998 salary expenses charged by FES plus imputed interest calculated through September 30, 2001, to the Federal Fund; and
- 6.2 Maintain documentation sufficient to support salary costs charged by FES.

NSLP Comments— NSLP disagreed with this finding. NSLP did not agree that the OMB Circular A-87 criteria applied to years subsequent to FY 1998. NSLP also stated that it has already provided OIG auditors with documentation sufficient to support its salary costs in FY 1998. NSLP provided that it has demonstrated that NSLP-designated employees are dedicated to the single cost objective of providing guarantor-related services. NSLP further stated, “. . . what was raised on the subject of unsupported salary costs was the issue of documentation. The Finding is based in large part on the OIG’s interpretation of OMB A-87, Attachment B, Section 11(h)(3). That Section requires periodic “certifications” from agency employees on a semi-annual basis. While it is true that no actual “certificates” were issued by NSLP in a formal sense, other significant formal checks and balances were in place and consistently applied” NSLP states that it provided payroll registers, annual reviews, and sick/vacation balance reports to support that employees were working on NSLP business.

OIG Response – NSLP’s response did not change our overall position regarding the finding. We deleted our recommendation relating to recoveries from years subsequent to FY 1998.

NSLP did provide documentation that supported the amounts FES paid employees, but the documentation did not show what portion of each employee's time was devoted to activity supporting NSLP, FES, CFSI, or FEF. Our review of the payroll registers, annual reviews, and sick/vacation balance reports did not support NSLP's claim that these FES employees were NSLP dedicated. Without this information, a determination of the reasonableness and allocability of NSLP salary costs cannot be made.

Finding No. 7 – Inadequate Standards of Conduct

NSLP did not maintain and update adequate standards of conduct to prevent and detect possible conflicts of interest. The standards were not consistent with regulatory provisions in that they did not require disclosures as to the interests of the NSLP directors and officers with respect to certain entities with which NSLP had contracts or agreements, and did not require any disclosures as to the interests of the immediate family members of NSLP directors and officers.

Under 34 C.F.R. § 682.410 (b)(11), guaranty agencies are required to “maintain and enforce written standards of conduct governing the performance of its employees, officers, directors, trustees, and agents engaged in the selection, award, and administration of contracts or agreements.... The standards must mandate disinterested decision-making [and] provide for appropriate disciplinary actions to be applied for violations of the standards” The potential conflicts of interest covered by these provisions include those that may arise with the immediate families of employees as well as the employees themselves.

NSLP did not satisfy these provisions in the following ways:

- NSLP's Policy for Managing Standards of Conduct and Conflicts of Interest was effective July 1, 1997. This policy required all NSLP officers and directors to complete a financial and other interest disclosure form provided by NSLP and to update the form on an annual basis. According to NSLP officials, disclosure statements dated August 1997 were the only ones they had on file.
- The disclosure forms only required disclosure as to the interests of NSLP directors and officers. The forms did not require disclosure of financial and other interests of the immediate family members of the directors and officers.

- The disclosure statements only required disclosure as to the interests NSLP directors and officers had in “external contracting parties” and listed only collection agencies and a guarantor systems servicer. The form made no reference to FES, with whom it had a management agreement for a number of services, or with any lending institutions, which, by the nature of the services NSLP provides, it would have had agreements.
- The President of NSLP was not a disinterested decision-maker because of personal interests and positions she had in organizations with which NSLP had financial relationships, i.e., she was a member of the boards of directors of FES and Collegiate Financial Services.

Recommendation

We recommend that the COO for FSA

- 7.1 Assure that NSLP’s conflict-of-interest standards adhere with federal regulations, particularly that NSLP
 - a) Obtains from its officers and directors disclosure of any interest they or their immediate family members have in entities with which NSLP has contracts or agreements, including but not limited to FES and its affiliates;
 - b) Updates its disclosure statements on an annual basis; and
 - c) Provides for appropriate disciplinary actions to be applied for violations of the standards.

NSLP Comments – NSLP did not fully agree with this finding but states that it has revised its disclosure statement to conform to the OIG recommendations and obtained signatures on the statements for FYs 1998 through 2001. NSLP states that the OIG working papers acknowledge that the Conflicts of Interest policy itself was in full compliance and that the criticisms were of several perceived deficiencies in the annual disclosure statements and NSLP’s failure to obtain signatures on an annual basis. NSLP also states that it believes that the prototype disclosure statement was adequate since it is simply a tool to assist in the administration of the formal Conflicts of Interest policy.

OIG Response – NSLP’s response did not alter our position. The OIG working papers referred to by NSLP did not acknowledge that NSLP’s Conflicts of Interest Policy was in full compliance. The working papers stated that “we reviewed NSLP’s written standards of conduct and found that in general the policy contained the requirements of 34 CFR 101.410(b)(11); however, the disclosure statements signed by the officers and directors only required disclosures as to interests in a few specific entities. The list did not include FES, with whom NSLP has service agreements (leases, equipment, etc.) or any lenders with whom the agency has guaranty agreements, both of which have been supported by reserve fund monies. The disclosure statements did not require the disclosure of immediate family interests in the entities and are not updated annually” The disclosure statements are an integral part of NSLP’s Conflicts of Interest Policy as noted in the policy itself. Paragraph I.A. of NSLP’s “Policy for Managing Standards of Conduct and Conflicts of Interest” provides that written standards of conduct require disclosure of financial and other interests. Further, Paragraph III. D. of the policy mandates all directors and officers to complete a disclosure form.

NSLP’s revised disclosure/policy statement (“Annual Disclosure Statement: Policy for Managing Standards of Conduct and Conflicts of Interest”), in Exhibit D, does not adequately respond to all of our recommendations in that it allows NSLP

- Board members to accept from FES or any of its affiliates Board and committee fees;
- Officers to accept from FES or any of its affiliates standard compensation packages;
- Directors and officers and other covered parties to benefit from contracts or agreements with FES or any of its affiliates in other than directly monetary terms (e.g., the benefits accruing to the President of NSLP resulting from her serving on the boards of directors of FES and Collegiate Financial Services); and
- NSLP directors and officers and other covered parties to have financial interests below specified thresholds in entities with which NSLP has contracts or agreements.

In addition, the revised disclosure/policy statement does not provide for appropriate disciplinary actions to be applied for violations of the standards and other than failures to disclose actual or possible conflicts of interest.

Other Matters

We noted an additional issue that warrants FSA's attention. NSLP did not have a cost allocation plan for costs billed to it from FES after FY 1998. According to an NSLP official the last cost allocation plan on file was for FY 1998, for which FES billed NSLP over \$5 million in staffing, building, equipment, information systems, and other costs. NSLP continues to share costs with FES.

The Higher Education Amendments of 1998 provided that the Department may not regulate the uses or expenditures of moneys in the Operating Fund, unless a loan is outstanding from the Federal Fund. As a result, a guaranty agency without a loan outstanding from the Federal Fund does not have to comply with the cost allocation plan requirements of 34 C.F.R. § 682.418 (c) (2001). (The current text of § 682.418 (c) predates the 1998 amendments and does not condition its application on the existence of an outstanding loan.)

The 1998 amendments also prescribed the permitted uses of the Operating Fund:

application processing, loan disbursement, enrollment and repayment status management, default aversion activities . . . default collection activities, school and lender training, financial aid awareness and related outreach activities, compliance monitoring, and other student financial aid related activities, as selected by the guaranty agency. (HEA § 422B (d)(1))

A cost allocation plan would provide assurance that funds are being used for appropriate purposes. Although cost allocation plans are no longer required of every guaranty agency, § 422B (e)(2) of the HEA authorizes the Department to require reports on the use of the Operating Fund. Reporting is needed for the Department to monitor use of the Operating Fund for statutory purposes.

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Background

Federal and Operating Funds

The Higher Education Amendments of 1998, enacted on October 7, 1998, required each guaranty agency to establish a Federal and Operating Fund within 60 days of enactment. All funds, securities, and other liquid assets previously held in an agency's reserve fund were to be deposited into a Federal Student Loan Reserve Fund (Federal Fund) by December 6, 1998.

The Federal Fund, which is used to pay lender claims and default aversion fees, is the property of the Department. The Operating Fund is used to pay for application processing, loan disbursement, enrollment and repayment status management, and other guaranty agency activities. It is the property of the guaranty agency, except for any funds it may contain by means of transfer from the Federal Fund. Funds transferred from the Federal Fund remain the property of the Department and are subject to federal regulations.

The National Student Loan Program

NSLP is the designated guaranty agency for Nebraska and is located in Lincoln, Nebraska. It is a private, not-for-profit business. NSLP established its Federal and Operating Funds on December 6, 1998.

An affiliated private, not-for-profit business, FES, provides office space, equipment, personnel, and support services to NSLP and to other affiliated businesses, all of which are housed in the same building. In FY 1998,⁵ NSLP paid FES⁶ over \$5 million for such services. The organizational chart in the exhibit at the end of this report shows the relationships between these affiliated businesses.

⁵ NSLP defines its fiscal year as being from October 1 to September 30. This definition is used throughout this report.

⁶ During part of FY 1998, FES was known as the Foundation for Educational Funding. In order to avoid confusion, this organization will be referred to as FES throughout this document.

Objectives, Scope, and Methodology

The objective of the audit was to determine whether NSLP complied with the HEA and regulations governing the establishment of its Federal and Operating Funds. The period covered by the audit extended from October 1, 1997 through December 1, 1998.

To accomplish our audit objective, we

- Reviewed the HEA and regulations, Department policy guidance, and program information;
- Reviewed NSLP's financial and single audit reports for the years ended September 1998 and 1999 to determine whether there were significant findings related to our audit;
- Reviewed the working papers of the independent public accountant who performed the FY 1999 Single Audit;
- Reviewed NSLP and FES accounting records and meeting minutes of boards of directors;
- Interviewed managers and staff of NSLP and FES; and
- Interviewed officials in the Department.

We judgmentally selected 7 of the 14 cost centers contained in FES' cost allocation plan based on our perception of which ones were most susceptible to including unallowable costs and would have the most impact on the opening balance of the Federal Fund. For each sampled cost center we recalculated allocation computations to assess accuracy. We reviewed line item expenses included as part of the allocation and assessed compliance with OMB Circular A-87. We judgmentally selected line item expenses in order to determine if they were reasonable, allocable, and consistent in treatment. For each sampled cost center, we judgmentally selected the line items with the largest amounts of expense and those that we perceived to be most susceptible to including unallowable costs.

To achieve our objective, we relied on data from FES' and NSLP's automated accounting systems. To assess the reliability of this data, we reviewed work completed by the independent

public accountant and conducted additional tests. We concluded that the data contained in NSLP's accounting system and FES' accounting system was sufficiently reliable to be used in meeting the audit's objective.

We performed on-site fieldwork at NSLP and FES offices periodically from January to September 2001 and continued to collect and analyze data in our offices through November 2001. We held an exit conference with officials of NSLP on September 24, 2001, and sent them updated information on November 30, 2001. On March 29, 2002, we issued a draft audit report, and on May 17, 2002 we received NSLP's comments on the draft report. Regulatory citations are from the 1998 Volume of the Code of Federal Regulations. We conducted the audit in accordance with government auditing standards appropriate to the scope of the audit described above.

Statement on Management Controls

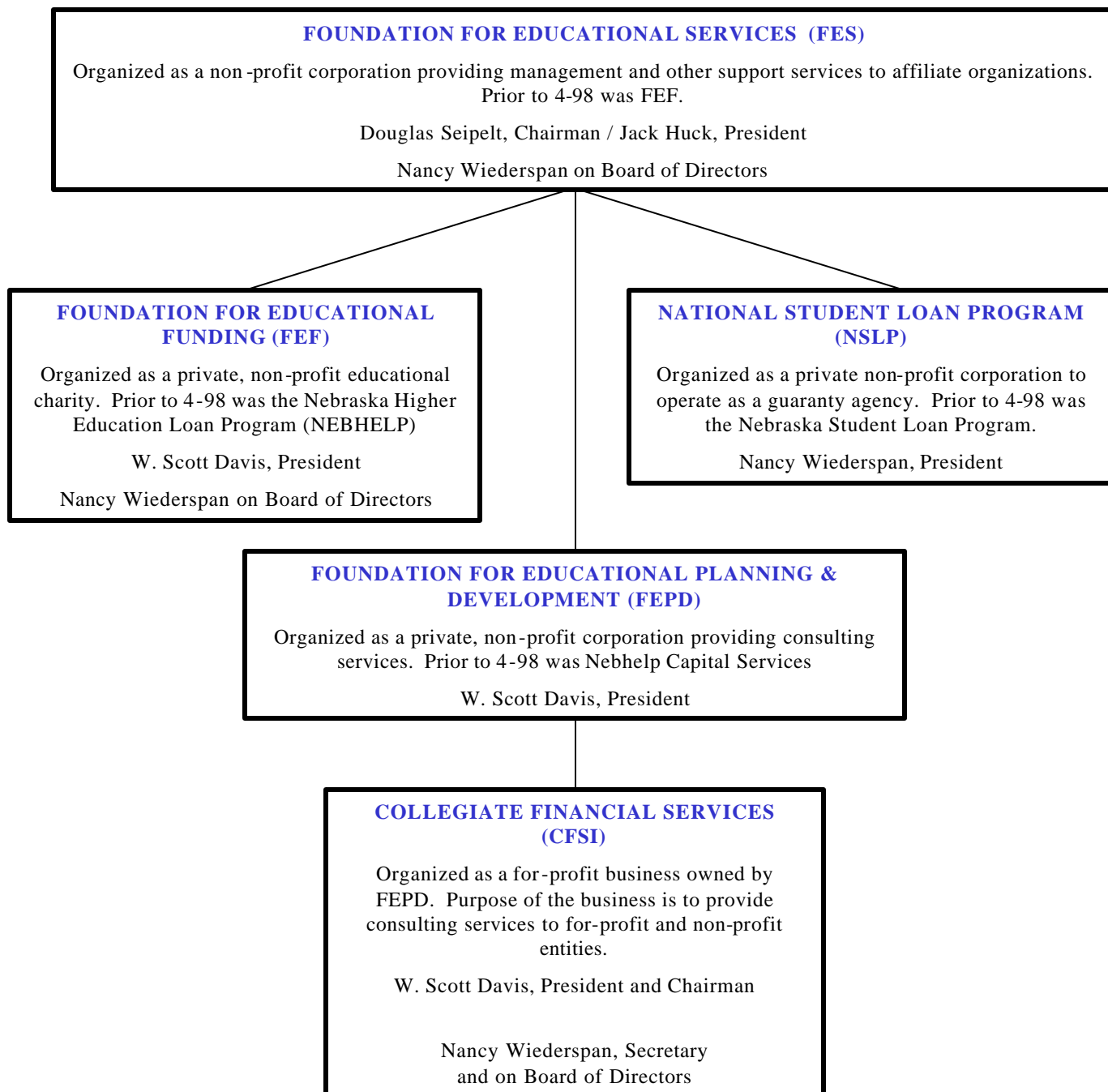
As part of our audit, we made an assessment of NSLP's management control structure, policies, procedures, and practices applicable to its administration of the FFEL programs. The purpose of our assessment was to determine the level of control risk, e.g., the risk that material errors, irregularities, or illegal acts may occur. We performed the control risk assessment to assist us in determining the nature, extent, and timing of the substantive tests needed to accomplish our audit objectives.

To make our assessment, we identified significant controls and classified them as follows:

- Establishment of the Federal and Operating Funds in compliance with HEA;
- Transactions involving the federal reserve fund, prior to the establishment of the Federal and Operating Funds, which significantly impacted the opening balances of the latter funds, e.g., payments made to FES and its affiliates; and
- Conflict of interest standards.

Due to inherent limitations, a study and evaluation made for the limited purpose described above would not necessarily disclose all material weaknesses in the control structure. However, we identified weaknesses in NSLP's controls over the transactions involving the federal reserve fund, prior to the establishment of the Federal and Operating Funds, that significantly impacted the opening balance of the Federal Fund. We also identified weaknesses in the conflict-of-interest management controls. We describe these weaknesses in the Audit Results section of this report.

**Organizational Chart of
FES and Its Affiliated Organizations
September 1998**



Appendix

NSLP Comments On The Draft Report

♦ We have included NSLP Appendices A, B, and D as part of this appendix. NSLP's Appendix C contained numerous personal identifiers and is on file at the Kansas City OIG office.



National Student Loan Program

May 16, 2002

Mr. William Allen
Regional Inspector General for Audit
U. S. Department of Education
10220 N. Executive Hills Blvd. Suite 200
Kansas City, MO 64153

Dear Mr. Allen:

NSLP writes in response to the Draft Audit Report (control Number ED-OIG/A07-B0002) regarding the audit of the National Student Loan Program's Administration of the Federal Family Education Loan Program Federal and Operating Funds. Our responses to each finding are set forth in the attachment to this letter. Where we disagree with findings or subparts of findings, we will take no corrective action unless directed by the Chief Operating Officer of Federal Student Aid. We appreciate the opportunity to comment on the draft.

Sincerely,

A handwritten signature in black ink, reading "Nancy Wiederspan", followed by a long, horizontal, wavy line that extends to the right.

Nancy Wiederspan
President

Enclosure

P.O. Box 82507, Lincoln, NE 68501-2507
1300 O Street, Lincoln, NE 68508
phone 402-475-8686 800-735-8776
fax 402-479-6658
www.nslp.org

**RESPONSE OF THE NATIONAL STUDENT LOAN PROGRAM
TO DRAFT AUDIT REPORT
PREPARED BY OFFICE OF INSPECTOR GENERAL
DATED MARCH 29, 2002**

PRELIMINARY STATEMENT

The following responses of the National Student Loan Program (“NSLP”) are provided in the context of the governing principles of the Inspector General Act of 1978, as amended (5 U.S.C. Appx. Subsections 1 - 12 inclusive) (the “Act”). According to the Act, the Office of the Inspector General exists to:

- (1) Conduct and supervise audits and investigations;
- (2) Promote economy, efficiency and effectiveness in the administration of an agency’s programs and operations, as well as detect and prevent fraud and abuse in such programs/operations; and
- (3) Keep agency heads and Congress informed about problems and deficiencies related to the administration of such programs/operations.

5 U.S.C. Appx. Subsection 2.

The principal conclusion in the draft report of the Office of the Inspector General (“OIG”) was that NSLP had properly complied (subject to certain exception findings) with the terms of the Higher Education Act in establishing its Federal Fund and Operating Fund. This response provides comment and explanation to the exception findings in the OIG’s draft report. In most instances, NSLP respectfully disagrees with the OIG’s findings and provides detailed, cogent and supporting explanations that reasonably distinguish and disprove the exception findings.

Given the abbreviated response period allotted to NSLP, the company reserves the right to augment its responses at a later date, and to seek reconsideration and appeal of any final findings or audit determinations.

FINDING #1 – UNALLOWABLE MARKETING AND PUBLIC RELATIONS COSTS

Summary of OIG Finding:

Statements in the Educational Planning Center (“EPC”) annual reports indicated that the purpose of the EPCs was to market the names and images of FES and its affiliates. The OIG concluded from the statements contained in the reports that the EPCs were actually marketing/public relations departments of FES and its affiliates and, as such, the cost associated with these services are not allowable under OMB A-87.

Agency Response:

For at least three independent reasons, NSLP respectively disagrees with this Finding.

First, the Finding is incorrectly based on OMB Circular A-87. The pertinent regulation is 34 C.F.R. Section 682.418 (1996), which incorporated only certain parts of Circular A-87. As the U. S. Department of Education explained in promulgating Section 682.418, “the Secretary has determined . . . that to ensure the efficient and effective operation of the FFEL Program, some cost items prohibited under those OMB Circulars A-87 and A-122 should be allowable under the FFEL Program, and some limits specific to the guaranty agencies should be imposed” 61 Fed. Reg. 49382 (September 19, 1996). Unlike OMB Circular A-87 Section 2 (“Advertising and public relations costs”), Section 682.418(b)(8) specifically allows “ordinary and necessary” public relations activities and elaborates what is “ordinary and necessary” in the context of a guaranty agency. Accordingly, the Finding applies the wrong rule in concluding that “marketing/public relations” costs are “not allowable under OMB A-87.”

Second, the Finding demands documentation for 1999, 2000 and 2001 EPC costs, on the assumption that there is a basis for regulating Operating Fund expenditures for marketing activities during that time. The Finding thus is not appropriately limited in time. Section 682.418(b)(8), which is the Department’s first explicit regulation of public relations activities undertaken by a guaranty agency, became effective on July 1, 1997, 61 Fed. Reg. 60426 (November 27, 1996). Beginning October 1, 1998, Section 682.418 no longer applied to NSLP. This is so because NSLP, pursuant to the Higher Education Amendments of 1998, constituted its Operating Fund without the use of loaned Federal Funds. By its express terms, Section 682.418 applies only “during the periods in which the Operating Fund contains transferred funds owed to the Federal Fund.” Accordingly, since October 1, 1998, NSLP has not been subject to the restrictions of Section 682.418. The Finding must be limited to the period between July 1, 1997 (the effective date of the regulation) and October 1, 1998 (the effective date of the Higher Education amendments).

Third, application of the correct rule (Section 682.418(b)(8)) during the correct period of time (July 1997 through October 1998) conclusively demonstrates that NSLP complied with the law. Section 682.418(b)(8) provides that “ordinary and necessary public relations activities include training of program participants and secondary school personnel and customer service functions that disseminate FFEL-related information and materials to schools, loan holders, prospective loan applicants, and their parents.” In fiscal year 1998, which is the pertinent period, EPCs provided 573 presentations to Nebraska colleges and high schools. Of those

presentations, 304 (or 53%) were documented to fall squarely within the allowances of Section 682.418(b)(8).

Specifically, there were 169 financial aid programs and 36 educational planning programs designed to educate and raise awareness of financial aid (including FFELP loans) available to prospective loan applicants. (See Exhibit A for an example of these programs, the “College Funding 101” brochure.) These programs served to “disseminate FFEL-related information and materials to schools, loan holders, prospective loan applicants, and their parents,” as expressly allowed by Section 682.418(b)(8). There also were 93 programs for entrance/exit counseling designed to educate students on the requirement to repay student loans and six college fairs. Again, these programs plainly complied with the pertinent regulations. Moreover, many of the meetings and activities *not* included in the documentation were authorized by Section 682.418(b)(8), because they were ordinary and necessary public relations activities. In short, the documented ratio of FFEL-authorized activities, 53 percent, is generous to the Federal fiscal interest. NSLP could have probably claimed a higher percentage.

As actually implemented, and permitted by Section 682.418(b)(8), NSLP’s cost allocation plan utilized a standard billing rate during the given fiscal year. That rate may or may not reflect the actual cost, which can only be determined at year-end. As such, the cost allocation plan provided for adjustments of standard cost to actual cost at year-end. Any refund or additional amount owed would be settled at the time. FES agreed to the 25% standard rate for fiscal 1998 to improve NSLP’s cash flow during the year. NSLP paid FES \$414,193 for EPC services in fiscal 1998. In conjunction with the anticipated year-end reconciliation, NSLP paid FES \$200,000 in addition to the agreed 25% (\$856,770 x 25%, or \$214,193) to ensure that NSLP’s portion of the contribution under the cost allocation plan would be closer to the ultimately-allocated amount that had otherwise previously been paid to date. FES could have allocated *at least* \$454,088 (total expenses of \$856,770 x 53%) to NSLP. FES therefore actually absorbed approximately \$40,000 in costs which could have been billed to NSLP. The actual allocation percentage was less than what has been documented (53%), which in turn was less than what Section 682.418(b)(8) authorized. NSLP could have properly charged *more* to the FFELP reserve fund than it did. For all of these reasons, there is no basis in fact for Finding #1.

FINDING #2 – UNALLOWABLE INFORMATION SYSTEM COSTS

Summary of OIG Finding:

NSLP used Federal Reserve funds to pay FES for Information Systems (“IS”) charges that FES could not collect from other customers.

Agency Response:

Finding #2 starts with a flawed premise and misapplies it to reach a wrong result. NSLP respectfully disagrees with the Finding.

The flawed premise of Finding #2 relates to CommonLine. During the audit, NSLP explained at length to the OIG why customer support and programming costs relative to CommonLine were reasonable, ordinary, and necessary. The draft OIG report does not appear to contend otherwise. Indeed, the OIG draft report correctly recites that CommonLine was the industry standard for transmitting data. Footnote 3 of the draft report also recognizes the value of CommonLine. Yet Finding #2 is based on the flawed premise that such costs are disallowable.

From this flawed premise, the OIG draft report goes on to reason that FES “could not collect” information system costs from UHEAA and USBR, and then inappropriately billed NSLP for such costs when there were “charges that the Utah organizations would not pay.” The draft report is incorrect. FES collected all that it was due from UHEAA and USBR pursuant to a fixed fee contract. There was no failure to collect and no refusal of the Utah organizations to pay. Moreover, the FFELP Federal Fund benefited from the fully-collected contract. It would have been necessary for NSLP to incur all of the noted CommonLine expenses whether FES had the Utah contracts or not. The contracts defrayed CommonLine costs that NSLP by necessity, and with regulatory authority, would have incurred even without the Utah contracts. The FFELP Reserve Fund would have appropriately incurred expenses of \$575,827 in connection with CommonLine, and thus benefited from the \$195,198 billed to and paid by the Utah agencies. For all of these reasons, the reimbursement demand set forth in Finding #2 is in error.

Finding #2 also recommends 1999 – 2001 reimbursement to the Operating Fund. There is no basis for such a demand. For the reasons explained in response to Finding #1, Section 682.418 did not apply to NSLP’s Operating Fund during this period.

FINDING #3 – DUPLICATED AND UNALLOWABLE BENEFIT COSTS

Summary of OIG Finding:

NSLP Used Federal Reserve Funds to pay for \$272,266 of duplicated benefits costs and unallowable benefits administration costs in two primary areas.

Finding A: Duplicative Employee Benefit Costs

The OIG concluded that \$757,007 of employee benefit costs included in the calculation of the employee benefit rate, applied by FES to direct salaries and direct charges to NSLP, were also included in its calculation of other rates and charges. The OIG reduced the original benefits amount of \$1,469,612 by \$757,007 in alleged duplicate employee costs and arrived at a new total of \$712,605 in benefits costs. The auditors divided the new amount by the total salary costs of \$4,879,865 and arrived at a revised rate of \$.146, compared to the original rate of \$.301.

Agency Response:

NSLP respectfully disagrees with Finding #3A. Because of the necessary complexities of the cost allocation plan, NSLP officials offered to walk through and generally explain the allocation process to the OIG auditors, who declined that offer.

In no instance were any costs ever recovered twice. Pursuant to the developed inter-building structure, FES, as a Section 509(a)(3) supporting organization, employs the general rank-and-file employees. The employees are then leased by FES to its affiliates. For employees leased to NSLP, FES allocated benefits as a percentage of salaries for those employees. (Benefits include insurance, retirement plans, and employer payroll taxes.) To create the allocation formula, total benefits expenses for all FES employees are divided by the total payroll dollars for all FES staff. The resulting rate is then applied to the salaries of employees leased to NSLP to determine total labor charges to NSLP. In FES's case, various service centers provide services to affiliate organizations. Salaries and benefits are part of the direct costs of those service centers and are included in determining the billable amounts for services provided to affiliates. The benefits costs allocated within the FES departments were the actual expenses for each benefit category -- not a percentage of the salaries. FES did not add any sort of benefits rate to its own departments' salary expenses.

The OIG auditors identified \$757,007 of benefits expenses that were recorded in the FES general ledger for FES employees working in various FES service centers, and then concluded that the amount was recovered more than once. That conclusion is incorrect. In their own work papers, the OIG auditors note they recalculated and traced to the payroll registers the total salary expense amount of \$4,879,864.79, without exception. Their work papers also disclose that the auditors recalculated the \$1,469,612 in benefits expense, without exception. The auditors concluded that the total salaries of \$1,734,182.72 for employees leased to NSLP was accurate.

At this point, the auditors actually confirmed all the information needed to test the reasonableness of the \$.301 benefits rate charged NSLP for leased employees. Approximately

35.5% (\$1,734,182 divided by \$4,879,865) of the total salaries were for employees leased to NSLP. Multiplying the total benefits expense of \$1,469,612 by 35.5% (the NSLP-leased employees percentage rate of total salaries), the benefits expense allocable to NSLP-leased employees totals \$521,712. Dividing the total benefits allocable to NSLP-leased employees by the total salaries of these employees achieves a billing rate of \$.301 (\$521,712 divided by \$1,734,182), which is the rate FES charged NSLP.

The OIG auditors declined to perform a reasonableness test consistent with the methodology identified above. Had they done so, the auditors would have determined that \$.301 was a valid benefits rate. Consequently, the OIG's recalculated rate of \$.146 is in error.

As criteria for the OIG's Finding on this subject, the report cites OMB A-87, Attachment A, Section C (Basic Guidelines—Costs). The guidelines recognize that “[a] cost may not be assigned to a Federal award as a direct cost if any other cost incurred for the same purpose in like circumstances has been allocated to the Federal award as an indirect cost.” Frankly, it is unclear to NSLP why the citation was used in this Finding to support the OIG's position, other than to suggest that certain direct costs were duplicatively billed as indirect costs. However, reaching such a conclusion in this case is erroneous, as demonstrated by the following explanation. Benefits include the employees' insurance and pension expense. These benefits costs are a direct charge to each of the FES cost centers. Whether they represent NSLP-leased employee charges, programming charges, network support charges, or the like, these benefits costs are a component of the direct labor costs of each employee, whose efforts can be economically traced to a specific department or cost objective. Therefore, the \$757,007 of benefits costs the OIG auditors removed from the FES cost centers must be included to accurately allocate all the direct labor cost associated with providing those shared services.

By reducing the total benefits expense by \$757,007 and then dividing that sum by the total salary expense (\$4,879,865), the auditors grossly understated benefits costs for NSLP-leased employees and FES-designated staff assigned to the various service centers providing services to NSLP. The following example illustrates the allocation process.

Example: (Figures are not actual and are used to illustrate methodology only.)

Total benefits/total salaries \$120/\$400 =30%

Labor Billing and Services Billed to NSLP				
	<u>NSLP Designated Staff</u>	<u>IS</u>	<u>Network Charges</u>	<u>Total</u>
Salaries	\$100	\$200	\$100	\$400
Benefit (30% X salary)	\$30			\$ 30
Pension costs		\$ 30	\$ 15	\$ 45
Insurance		<u>\$ 30</u>	<u>\$ 15</u>	<u>\$ 45</u>
Total labor cost	\$130	\$260	\$130	<u>\$520</u>
Other G & A	<u>NA</u>	<u>\$200</u>	<u>\$150</u>	
Total billed & allowable	<u>\$130</u>	<u>\$460</u>	<u>\$280</u>	
Hours billed		4 hrs.		
Work stations			3	

Billing rate	115/hr.	\$93.33/ wk. station
NSLP Charges:		
Leased Employee Charge	\$130	
I.S. for 2 hrs @ \$115 hr.	\$230	
Network for 2 work stations	\$187	

As demonstrated by this example, benefits are billed to NSLP as part of the direct labor charge for each area providing services to NSLP. For leased employees, the total direct benefits charge is \$30. For the two hours billed for I.S. services, NSLP is charged \$30 for direct benefits costs (total I.S. benefits expense of \$60 divided by total hours billable of 4 multiplied by the hours billed to NSLP of 2). For the network charge, NSLP is billed \$20 of direct benefit costs (total benefits expense for network support of \$30 dollars divided by a total of 3 workstations multiplied by the 2 workstations utilized by NSLP). In this example NSLP has paid a total of \$80 in direct benefits charges for the services provided from each area. The remaining direct benefits charges of \$40 would have been allocated to other affiliates.

In this example FES has recovered \$80 of benefits expense from NSLP and \$40 of benefits expense from other affiliates. Total benefits expense recovered by FES is \$120 (\$80 + \$40). Total amount expended is \$120. This example illustrates the cost accounting employed by FES and demonstrates that FES has not recovered more than the cost of the benefits provided.

Finding B: Unallowable HR Costs Benefits

The OIG found that FES included a number of costs in the Human Relations (“HR”) benefits cost pool that are unallowable per OMB Circular A-87, Attachment B, Section 18.

Agency Response:

NSLP respectfully disagrees with this Finding. Rather than focusing on Section 18 of Attachment B of OMB A-87, the more relevant and applicable portion of OMB A-87 is found in Section 17, which provides:

Employee morale, health, and welfare costs: The costs of health or first-aid clinics and/or infirmaries, recreational facilities, employee counseling services, employee information publications and any related expenses incurred in accordance with a governmental unit’s policy are allowable.

The Finding identified costs incurred for Employee Appreciation Day, employee relations, holiday party and wellness committee as constituting unallowed expenses. The Finding states NSLP was over charged \$3,468 due to the inclusion of these expenses in the FES cost pool. These expenses are intended to improve employee morale and are specifically allowed under OMB A-87. Finding #3B is in error.

FINDING #4 – UNALLOWABLE ADMINISTRATION COSTS

Summary of OIG Finding:

NSLP used Federal Reserve Funds for unallowable administration costs in the amount of \$41,205 (\$14,852 of directly billed insurance costs and \$26,353 of other indirect charges).

A. Insurance:

The OIG concluded that the amount of Director and Officer liability insurance (“D & O”) allocated to NSLP was overstated because twelve of the thirteen personnel listed on the insurance policy did not work for NSLP. It also concluded that the policies covered periods beyond the FY 1998 term.

Agency Response:

NSLP respectfully disagrees with most elements of this particular Finding, as well as the formula employed to compute the proposed reimbursement amounts. The report states the auditors analyzed the invoices and policy terms of insurance policies. The D & O insurance was for NSLP and FES (formerly FEF). In their analysis of the D & O policy, the auditors overlooked Endorsement #8, dated June 1, 1997. That endorsement clearly lists both NSLP and FES as corporations for which coverage was being provided. The OIG auditors apparently assumed the D & O policy was an FES policy only. Given the fact that NSLP’s president, Nancy Wiederspan, was also an FES Director, one could conclude (without further inquiry) that only one-thirteenth of the \$20,000 would represent NSLP’s allocated share. That assumption is incorrect, however, when all relevant facts are considered.

The policy covered two companies, NSLP and FES. The premium was \$10,000 per company; each company is clearly listed on the policy (see Endorsement #8, Exhibit B). The insurance company, AON, invoiced FES the full \$20,000. FES then billed NSLP for its policy. The fact that a single invoice was sent does not change the substance of the transaction. NSLP and FES each had a \$10,000 policy. The NSLP premium of \$10,000 was a pass-through billing, and the \$10,000 related to FES constituted an indirect allocation element applied to the cost allocation formula.

The policies ran from June 1, 1998 to May 30, 1999. NSLP agrees that a portion of the premiums covered a period beyond fiscal year 1998. Of the \$10,000 NSLP paid directly, \$6,658 (243 days divided by 365 times \$10,000) would be considered a prepayment for coverage after September 30, 1998. Likewise, FES’s \$10,000 policy would have a prepayment of \$6,658. NSLP agrees that the amount of the \$6,658 prepayment paid by NSLP in fiscal year 1998 is unallowable and will reimburse the Federal Fund accordingly. Moreover, any portion of the FES prepayment passed on to NSLP during fiscal year 1998 must also be adjusted, and NSLP will reimburse the Federal Fund consistent with the adjustment amount.

NSLP directly paid a premium in the amount of \$5,934 for a corporate liability policy. That policy ran from August 27, 1998 to August 26, 1999. NSLP agrees that a portion of the premium cost is attributable to a period beyond fiscal year 1998, and will reimburse \$5,365 to the Federal Fund (\$5,934 times 330 days prepaid divided by 365 days) for that prepayment.

Likewise, FES included \$5,365 of prepaid insurance (which was included in FES cost centers) and NSLP will reimburse the Federal Fund for any portion so allocated.

FES had a blanket bond that ran from June 1, 1998 to May 30, 1999. NSLP agrees that a portion is attributable to a period beyond fiscal 1998 and will reimburse the Federal Fund for the portion of the \$7,099 premium cost (\$10,663 times 243 days prepaid divided by 365) attributable to it.

B. Personnel Administration:

The report contends that severance pay of \$25,805 to a former employee is not allowable since, according to the employee contract, FES was not obligated to provide severance pay due to his resignation. The report then quotes from Section 8 of the employee's employment contract. The report also references OMB A-87 which provides, in relevant part, that payments in addition to regular salaries and wages made to workers whose employment is being terminated are allowable to the extent that, in each case, they are required by (a) law, (b) employee agreement, or (c) established written policy."

Agency Response:

NSLP respectfully disagrees with the conclusions of the OIG on this subject, and submits that the severance payment should be allowable. It was a settlement made by management to avoid risks of litigation and legal expenses. The employee was being terminated for cause. The employee believed he was being terminated without cause and would seek legal recourse. Management believed it less expensive to make the settlement payment than to pay the legal costs of litigation. As such, NSLP does not agree with the finding. Since this response will be published and the details of the employment case are the subject of a confidentiality provision, such details have not been specifically disclosed in this response.

C. Directors Fees and Expenses:

The Finding identifies an allocation of \$11,581 to FES cost centers as an unallowable indirect cost.

Agency Response:

NSLP concurs with this particular Finding and will reimburse the Federal Fund accordingly.

Agency Recap on Finding #4:

NSLP will repay \$12,023 (\$6,658 + \$5,365) of direct insurance cost to the Federal Fund.

NSLP has recalculated the \$26,353 of indirect charges (discussed in items A, B and C above) based on its belief that the \$25,805 severance payment is an allowable expense. The recalculated indirect charges is \$14,056, which will likewise be reimbursed to the Federal Fund.

Based on NSLP's computations, the total amount to be reimbursed to the Federal Fund under Finding #4 is \$26,079.

OIG FINDING #5 – UNALLOWABLE COMMUNICATIONS AND DESIGN COSTS

Summary of OIG Finding:

NSLP used Federal Reserve funds to pay for \$4,971 of certain unallowable communication and design costs.

Agency Response:

The report identifies several advertising, design and communication costs that it asserts are unallowable under OMB A-87, to wit: (i) a college fair advertisement; (ii) KEZG Festival of Music; and (iii) certain dues and subscriptions. NSLP disagrees with disallowance of the college fair advertisement cost, since the college fair function is a reasonable and allowable expense under the Higher Education Act. See response to Finding #1, *supra*. NSLP agrees with the Finding as it relates to the KEZG Festival of Music outlay and will reimburse the Federal Fund for any portion that was allocated to NSLP.

NSLP disagrees with the disallowance for dues and subscriptions (including membership dues to the Lincoln Chamber of Commerce) on the basis that such costs are allowable under Section 30 of OMB A-87, which states as follows:

OMB A-87 Section 30. Memberships, subscriptions, and professional activities:

- a. Costs of the governmental unit's memberships in business, technical and professional organizations are allowable.
- b. Costs of the governmental unit's subscriptions to business, professional, and technical periodicals are allowable.
- c. Costs of meetings and conferences where the primary purpose is the dissemination of technical information, including meals, transportation, rental of meeting facilities, and other incidental costs are allowable.
- d. Costs of membership in civic and community, social organizations are allowable as a direct cost with the approval of the Federal awarding agency.

As for the remaining \$2,631, NSLP agrees with the Finding and will reimburse the Federal Fund for any portion that was allocated to NSLP.

OIG FINDING #6 – UNSUPPORTED SALARY COSTS

Summary of OIG Finding:

The OIG determined that FES charged NSLP approximately \$1.73 million in fiscal year 1998 in salary expenses that were not supported by required documentation.

Agency Response:

From the outset, it is important to point out that the OIG recommends NSLP provide required supporting documentation for the \$1.73 million in salary expenses charged by FES in fiscal year 1998 and later years. The Finding recommends reimbursement only of “questioned amounts,” which presumes reimbursement only if NSLP is unable to provide adequate supporting documentation.

NSLP respectfully disagrees with the Finding and recommendations of the OIG for several reasons. First, it is recommended that, in addition to FY 1998, NSLP provide supporting documentation for the salary costs charged by FES for fiscal years 1999, 2000 and 2001. As articulated in NSLP’s Response to Finding #1, the portion of this Finding and the recommendation of the OIG is not appropriately limited as to time. After October 1, 1998, Section 682.418 becomes applicable only during those periods in which federal funds have been transferred to the Operating Fund. As noted previously, NSLP has at no time after October 1, 1998, constituted its Operating Fund with funds loaned from the Federal Fund. The Finding and recommendations must therefore be limited to the period of July 1, 1997 through October 1, 1998.

Second, the Finding points out that 34 C.F.R. Section 682.410(a)(2)(ii) requires a guaranty agency to use assets of the reserve fund to pay only the costs that are ordinary, necessary and reasonable for the fulfillment of its obligations under the Higher Education Act, and that the burden is on the guaranty agency to establish the reasonableness of those costs. The company has demonstrated that NSLP-designated employees are dedicated to the single cost objective of providing guarantor-related services for the National Student Loan Program. NSLP provided numerous verification reports and significant supporting documentation on the subject and the issue of cost reasonableness was never a serious question raised by the OIG in either the draft report or its working papers.

What was raised on the subject of unsupported salary costs was the issue of documentation. The Finding is based in large part on the OIG’s interpretation of OMB A-87, Attachment B, Section 11(h)(3). That Section requires periodic “certifications” from agency employees on a semi-annual basis. While it is true that no actual “certificates” were issued by NSLP in a formal sense, other significant formal checks and balances were in place and consistently applied.

In fact, FES provided the OIG auditors with an individual-detailed payroll register as well as microfiche that reconciled to the NSLP payroll amount billed monthly by FES.

Each employee designated to NSLP had an annual review signed by his or her immediate supervisor. Additionally, FES issued quarterly sick and vacation balance reports to supervisory officials having first-hand knowledge of the work performed by the NSLP-designated employees. (See, e.g., Exhibit C, which includes quarterly reports for NSLP's account maintenance department.) Recipients were instructed to verify and notify the Human Resources office if issues existed relative to compliance or attendance. In addition, employees were allowed to convert accrued sick time to vacation time on a semi-annual basis. As such, supervisors were instructed to return completed forms for any employees requesting conversion of accrued sick time to vacation to the Human Resources office.

A total of five employee reviews/verifications were prepared and/or overseen for each employee, on an annual basis, by NSLP managers and supervisors during the relevant period. FES and NSLP have substantially met the spirit of OMB A-87, and the spirit and letter of sound accounting principles on the subject. Costs paid for direct salary expenses have been adequately reported on a contemporaneous basis during the period OMB A-87 applies (July 1, 1997 to October 1, 1998) and should therefore be fully allowed.

Finally, the company enjoys a low turnover of NSLP-designated employees. Approximately 80% of the individuals who worked as NSLP-designated employees between July 1, 1997 and October 1, 1998 are still employed within the building. NSLP can readily obtain signatures from employees on certificates having a form as generally contemplated by Attachment B, Section 11(h)(3), which would then substantially comply with the recommendations of the OIG on this Finding relative to the period in which OMB A-87 applies. NSLP will undertake obtaining signatures from employees on such certificates if it would assist in compliance of this requirement, which would be in addition to the other contemporaneous, objective documentation NSLP has produced to support the reasonableness of the salary costs.

OIG FINDING #7 – INADEQUATE STANDARDS OF CONDUCT

Summary of OIG Finding:

NSLP did not maintain or update adequate standards of conduct to prevent and detect possible conflicts of interest.

Agency Response:

From the outset, it is important to point out that the OIG work papers acknowledge that the Conflicts of Interest policy itself was in full compliance. The OIG's criticisms run to several perceived deficiencies in the annual disclosure statements and NSLP's failure to obtain signatures on them on an annual basis. It is NSLP's belief that the prototype disclosure statement is in fact adequate, since it is simply a tool to assist in the administration of the formal Conflicts of Interest policy. That policy, which contains all material provisions required by 34 C.F.R. §682.410(b)(11), is made available to, known by, and generally addressed on a regular basis with Board members and officers of the company. Nonetheless, in order to conform with the recommendations of the OIG on this Finding, NSLP has revised the disclosure statement (see Exhibit D) and obtained signatures on disclosure statements for fiscal years 1998 through 2001 from all members of the Board of Directors and the executive officers.

OIG FINDING #8 – COST ALLOCATION PLAN

Summary of OIG Finding:

NSLP did not have a cost allocation plan for costs billed to it from FES after FY 1998. It is the OIG's view that, in accordance with 34 C.F.R. Sec. 682.418(c), a guaranty agency that shares costs with another program, agency, or organization must develop a cost allocation plan and maintain the plan and related supporting documentation for audit.

Agency Response:

NSLP respectfully disagrees with the Finding. For the reasons set forth in response to Finding #1, NSLP is not subject to Section 682.418(c) and thus is not required to have a cost allocation plan similar to those required by OMB A-87. Nonetheless, NSLP and FES still utilize a cost allocation methodology as part of the annual budgeting process and year-end actual cost adjustments. NSLP does so because sound accounting practices require it. NSLP and FES had a cost allocation methodology long before OMB A-87 was applicable to guaranty agencies and continues to follow a cost allocation methodology even though OMB A-87 no longer applies. There is no basis either in fact or law for the Finding.

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ENDORSEMENT # 8 (REVISED)

This endorsement, effective 12:01 AM June 01, 1997

forms a part of

policy number 485-55-41

issued to

FOUNDATION FOR EDUCATIONAL FUNDING, INC.

by

National Union Fire Insurance Company of Pittsburgh, Pa.

**DIRECTORS AND OFFICERS INSURANCE AND COMPANY REIMBURSEMENT POLICY
DEFINITION OF COMPANY**

In consideration of the premium charged, it is hereby understood and agreed that the term "Company" is amended, in part, to include the following entities:

Nebraska Student Loan Program, Inc.

It is further understood and agreed that this policy provides coverage only for claim or claims against the Directors or Officers of each of the above listed entities for alleged Wrongful Acts occurring on or after the date of creation or acquisition of such entity, and otherwise covered by this policy.

All other terms and conditions of the policy remain unchanged.


AUTHORIZED REPRESENTATIVE

MEMORANDUM

The Officers and Directors of
Nebraska Student Loan Program, Inc.

FROM: Paul J. Peter

Annual Disclosure Statement:
Policy for Managing Standards of Conduct
and Conflicts of Interest
[1998] [1999] [2000] [2001]

Effective July 1, 1997, NSLP adopted written standards of conduct applicable to employees, officers, and directors engaged in the selection, award and administration of contracts or agreements. The standards require disclosure of interest of the employees, officers and directors with whom the company contracts, as well as other relevant parties, in order to assure that the decision-making process associated with a contract or agreement supported by federal or operating funds will not be biased by any conflicting financial or other interests. The potential conflicts of interest covered by this policy include those that may arise with immediate family members of the employees, officers and directors as well.

In order to comply with the Conflicts of Interest Policy, we are requesting all officers and directors to provide disclosures as to any ownership or investment interest, compensation arrangement or potential ownership or investment interest in or compensation arrangement with any entity or individual with which NSLP has a business relationship, has entered into contracts or agreements, or is otherwise negotiating a contract or other transaction arrangement. The disclosures must include contracts or other relationships by immediate family members. Such entities may include, but are not limited to, those listed on the attached Schedule A.

We are also requesting officers and directors to provide disclosures as to whether you or an immediate family member have an ownership or investment interest in or compensation arrangement with NSLP, the Foundation for Educational Services, Inc. or any of its affiliates. Such arrangements do not include Board and committee fees for Board members and standard compensation packages for officers.

The term "financial interest" generally means any thing of monetary value including, but not limited to, (i) salary or other payments for services rendered such as director or consulting fees; (ii) equity interests such as stocks, stock options or other ownership interests; and (iii) intellectual property rights such as patents, copyrights, and royalties from such intellectual property rights. For purposes of disclosure of this form, a financial interest does not include having a financial interest in (i) a closely-held corporation with stock ownership of \$1,000 or less in fair market value or which represents less than 5% equity interest; or (ii) publicly traded stock

worth less than \$10,000 at fair market value or which represents less than a 10% equity interest. You do not need to report potential holdings in any of the above identified entities if they are held in mutual or other funds or are publicly traded stock under a trading account. However, in such case, you may be requested to provide the name and address of the mutual fund or stockbroker.

In accordance with NSLP's Conflicts of Interest Policy, if the Board of Directors has reasonable cause to believe that an officer or director has failed to make proper disclosure, such individual will be so informed and afforded an opportunity to explain the alleged failure to disclose. If following such response (and the making of further investigation as may be warranted), the Board determines that the individual has in fact failed to disclose an actual or possible conflict of interest, it shall then take appropriate corrective and disciplinary action.

If you or an immediate family member have any financial or other interest in one or more of above-identified entities, please describe at the bottom of this page or on a separate sheet (attaching it to this memo) the financial or other interest with sufficient particularity. The description should include receipt of a financial benefit or detriment affecting yourself, a member of your immediate family or any business with which you are associated. You should also provide a summary of the nature of the financial benefits.

If you do not have any such financial or other interests, please check the box below and sign this memorandum.

- ☐ No financial or other interests that may give rise to a conflict of interest as described in this memorandum.

Effective: December 31, **[1998] [1999] [2000] [2001]**.

Printed Name: